

## Insights

# INDONESIA AND RENEWABLES: OLD BOOTS MAKE WAY FOR NEW SHOES?

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From its inception on 8 August 2017, the Build, Own, Operate and Transfer (“**BOOT**”) scheme (the “**BOOT Project Model**”) has often been cited as a significant barrier to developing renewables in Indonesia<sup>1</sup>, alongside the tariff framework and local content policies. Energy and Mineral Resources Minister Arifin Tasrif’s<sup>2</sup> decision to sign a regulation revoking the BOOT Project Model requirement is, therefore, a notable development for Indonesia’s renewables sector and a positive signal to investors and financiers<sup>3</sup>.

Drawing from Indonesia’s constitutional roots and the challenges associated with the BOOT Project Model, this article considers the project development and financing models likely to drive Indonesia’s renewable energy growth into the future and why a deeper focus on the substance of the arrangement, rather than the name stated on the label, may lead to more constructive dialogue between policy makers and stakeholders engaged across the development process.

The Ministry of Energy and Mineral Resources’ (“**MEMR**”) revoked the requirement for on-grid renewables projects, which sell electricity to PT PLN (Persero) (“**PLN**”), to be developed using the BOOT Project Model under MEMR Regulation No. 4 of 2020 (the “**Second Amendment**”) regarding the second amendment to MEMR Regulation No. 50 of 2017 on the Utilisation of Renewable Energy Resources in Electricity Production (the “**2017 Regulation**”).

The 2017 Regulation applies to power plants using solar, wind, hydropower, biomass, biogas, waste, geothermal energy and ocean/tidal. Liquid biofuel was added to the list under MEMR Regulation No. 53 of 2018 regarding the first amendment to the 2017 Regulation.

Our analysis of the key features of the Secondment Amendment can be found in our [April edition of Indonesia in focus](#).

## A Constitutional Footprint

The requirement for new power purchase agreements with PLN (“**PPA**”) to reflect the BOOT Project Model had its genesis in Constitutional Court (the “**Court**”) Decision No. 111/PUU-XIII/2015 (the “**Decision**”) <sup>4</sup>. The Decision ruled that Law No. 30 of 2009 (the “**Electricity Law**”) is conditionally

unconstitutional but only to the extent that the unbundling of the power supply chain, and/or private involvement in the supply of electricity for public purposes, takes place outside the limits of state control.

As a critical sector of production, the electricity supply business must be 'controlled' by the State under article 33(2) of Indonesia's 1945 constitution. It is open to interpretation, however, as to how 'control' can and should be defined and applied in the context of various parts of the power sector.

The Court held that government control involves both governance functions and management functions. Controls may be imposed through the authority to issue regulations, issue and revoke licenses and permits as well as the ability to manage the sector through state owned enterprises and the ownership of shares in other enterprises.

Indonesian academics have publicly noted that the Court's definition of 'control' is consistent with the prospect of private ownership of power generation assets by independent power producers ("IPPs"). However, MEMR appears to have taken a contrarian view by requiring IPPs to transfer their renewable assets to PLN on the expiry of the PPA. MEMR's adoption of the BOOT Project Model, together with other adjustments of risk allocation under the PPA, was met with criticism, with stakeholders finding the position difficult to reconcile with the Court's Decision.

How the BOOT scheme was to be accomplished in practice and in particular, the meaning of the "T" was not clearly defined in the 2017 Regulation, leaving the terms to be negotiated with PLN in the PPA.

## **BOOT problems**

The range of problems associated with BOOT financing structures varies considerably between different projects. However, adding an additional "T" at the end of a Build, Own and Operate ("BOO") project is likely to make it even more complex and difficult, particularly in relation to the valuation and tax and accounting treatment of utility assets.

The value of the project assets, and thus the attractiveness of the project to investors, tends to decrease if there is a need to value and transfer such assets to the government at the end of the PPA period.

Under the BOOT Project Model, it was envisaged that all assets, including land, buildings and equipment, would be transferred by the IPP to PLN on the expiry of the PPA. Questions must be asked about the ownership and valuation of the land on which the project assets sit, including if the developer will be responsible for land acquisition and if so, whether the "T" allows the IPP to enjoy any appreciation in land values.

Negative covenants associated with the BOOT Project Model may restrict the IPP from securing the renewable assets as collateral in favour of the project's lenders, which in turn may raise the cost of financing or limit access to finance altogether. BOOT schemes may become more attractive to the

private sector if the government provides the land for the renewable power plant – something that was not on the table in the case of the BOOT Project Model.

From an operational standpoint, the commercial incentive to maintain the renewable assets is reduced if there is a requirement to transfer them to the government for a knock-down price at the end of the concession period. Operational risks arise for the handover – it would be an oversimplification to consider the “T” as a simple transfer of title, without training and other orderly handover measures. The additional costs involved will, inevitably, limit the attractiveness of the project.

### **If not a BOOT, what shoe fits?**

As the requirement of the BOOT Project Model has now been revoked, developers of utility-scale renewables are likely to return to negotiating the terms of conventional procurement models with PLN, such as the BOO scheme and its various iterations such as Design, Build, Finance, Operate and Maintain (“**DBFOM**”).

Build, Operate and Transfer (“**BOT**”) schemes, where state assets in the form of land, plant or technology/equipment owned by an SOE may be utilised on a cooperation basis with the private sector for the purposes of developing renewables, may be considered. The PPP scheme, although not widely used for renewables, is another option for the development and financing of newly constructed renewable projects requiring access to government guarantees.

However there is also room to consider new and innovative financing structures in order to get deals across the line. Private equity or venture capital funds may use their dry powder to take advantage of Indonesian fund structures, such as RDPT (*Reksa Dana Penyertaan Terbatas*) and DINFRA (*Dana Investasi Infrastruktur*), which can be used on a single asset or aggregated basis, for example where battery storage or other cutting edge technology is incorporated into the project.

The RDPT model, for example, involves the establishment of a limited participation mutual fund under a collective investment contract as a potential funding source for ‘real asset’ projects.

Until the market is more developed, project structures will often continue to benefit from catalyst financing and the presence of multilateral/donor support or export credit agencies. Each will have an important role to play, provided Indonesia can adjust its policy framework to allow the sector to flourish.

### **What is in store for the future?**

Indonesia faces many pressing challenges that constrain existing power systems, including risks relating to grid stability. Despite an increasing focus on renewables, complemented with the use of natural gas, coal-based power plants continue to dominate Indonesia’s electrification programme. The country’s national target, involving a 23% renewable energy mix by 2025, is often cited but would require an investment of more than US\$ 20 billion over the next 5 years. This would involve

the formidable challenge of procuring an additional 12 GW of renewables, from the current on-grid base of 7.8 GW.

Despite querying if the national targets are achievable, PLN has launched a renewables growth plan named the “Green Program”. PLN will focus on large-scale renewables projects, together with a number of “Green Boosters”. This includes the deployment of renewables in a range of specific scenarios from solar PV in ex-mining sites, to hydro plants in public dams on a multi-purpose basis.

The feasibility of these initiatives, combined with a growing number of competing priorities and issues, are currently under discussion and will need to be addressed in the next electricity supply business plan (RUPTL) – from the risk of over-capacity on the Javi-Bali grid to the urgent need to address gaps in the electrification ratio in rural areas which often have no grid access at all.

## **Conclusion**

Proposed investment models and overall investment attractiveness, can suggest varying ideas. Much can be said for avoiding getting too caught up on the name used to defined the arrangement – whether BOO, BOOT or DBFOM. Much like Cinderella and the ball, no single shoe fits.

The investment requirement is substantial. With the limitations of the state budget, the private sector will play an indispensable role. Plenty of global capital is ready to invest in Indonesia’s huge potential – but this will depend on offering an investment structure which reflects the right level of de-risking to attract wide investor interest.

Unpopular policies, such as the tariff regime and local content requirements, need to be tackled together with investment limitations such as the ownership cap on sub-10-MW projects. It is hoped that new regulations, expected later this year, will address some of these issues.

Minister Arifin Tasrif and the newly appointed directors and commissioners of PLN have their work cut out. But if they can find the right mix of renewable energy projects for Indonesia, the country could well be on its way to becoming once again the Prince Charming of the Southeast Asian power sector.

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<sup>1</sup>IESR (2019). Indonesia Clean Energy Outlook: Tracking Progress and Review of Clean Energy Development in Indonesia. Jakarta: Institute for Essential Services Reform (IESR).

<sup>2</sup>Energy and Mineral Resources Minister Arifin Tasrif was appointed to his post on 23 October 2019, as part of President Jokowi’s onward cabinet for 2019-2024.

<sup>3</sup>Further reform, such as the re-introduction of a feed-in-tariff policy for renewables, is anticipated but not yet issued as of 12 May 2020.

<sup>4</sup><https://www.beritasatu.com/ekonomi/412443/kontrak-pembangkit-listrik-wajib-terapkan-skema-boot>

## MEET THE TEAM



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